

Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 USNATO 1699

E.O. 11652: GDS

TAGS: PROF,ECON, NATO

SUBJECT: ECONADS: PAPER ON STRATEGIC AND POLITICAL IMPLICATIONS
OF ECONOMIC SITUATION

REF. A. USNATO 1623

B. USNATO 1647

C. USNATO 1489

D. STATE 12084

E. USNATO 831

SUMMARY: AS RESULT OF ECONADS MEETING MARCH 24-25, COMMITTEE
AUTHORIZED ECONOMIC DIRECTORATE TO DRAFT REVISED REPORT ON IMPLICA-
TIONS OF ECONOMIC SITUATION BASED ON US PAPER, BUT TAKING INTO
ACCOUNT CURRENT DATA AVAILABLE FROM OECD AND SUGGESTIONS BY OTHER
ALLIES FOR ADDITIONS AND MINOR MODIFICATIONS. DIRECTORATE HAS MADE
AVAILABLE TO US ECONAD ADVANCE COPY OF REVISED DRAFT WHICH WILL BE
SUBMITTED FOR COMMITTEE REVIEW APRIL 7. AIM OF ECONOMIC COMMITTEE
IS TO SEND STUDY TO SPC BY APRIL 15 WITH UNDERSTANDING THAT IT WILL
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SERVE AS BASIS FOR FURTHER DISCUSSION IN THAT FORUM. END SUMMARY.

1. ECONADS MEETING MARCH 24 AND 25 REVIEWED IN DETAIL ENTIRE US
PAPER ON STRATEGIC AND POLITICAL IMPLICATIONS OF ECONOMIC

STITUTION (AC/127-WP/423). ASIDE FROM MINOR MODIFICATIONS, ADDITIONS, AND DELETIONS SUGGESTED BY OTHER DELEGATIONS AND UPDATING OF STATISTICS BASED ON MOST RECENT AVAILABLE OECD DATA, ONLY MAJOR ALERTATIONS IN US PAPER AGREED TO WERE INCLUSION OF FRG VIEWS (REF C PARA 2) IN PARAGRAPH 7 AND USE OF INTERESTING GERMAN IDEAS (REF C PARA 31) IN NEW PARAGRAPH WHICH ECONOMIC DIRECTORATE PREPARING CONTAINING MAIN CONCLUSIONS OF STUDY. US ECONAD SUPPORTED THIS PROCEDURE SINCE THERE WILL BE AMPLE OPPORTUNITY FOR FURTHER DISCUSSION IN SPC AND NAC, AND IN VIEW OF FACT WE MADE CLEAR TO ALLIES FROM BEGINNING THAT US PAPER REPRESENTED OUR INITIAL VIEW TO SERVE AS STARTING POINT FOR ACTIVE PARTICIPATION BY ALL ALLIES IN WIDERANGING DISCUSSION OF ISSUES INVOLVED (REFS D AND E).. WITH THIS PROCEDURE, SPC WILL HAVE OPPORTUNITY TO CONTINUE DISCUSSION BASED ON PAPER IN WHICH ALLIES' VIEWS ARE RECOGNIZED AND INCLUDED RATHER THAN SUPPRESSED.

2. ECONOMIC DIRECTOR HAS PROVIDED USECONAD ADVANCE COPY OF NEW DRAFT. TEXT OF PARAGRAPHS 1 THRU 12 FOLLOWS (PARA 4 BELOW), EXCEPT FOR PARAS 8 AND 9 WHICH US ASKED TO PROVIDE (REF B). NEW REVISED DRAFT OF REMAINING PARAGRAPHS FOLLOWS SEPTTEL.

3. ACTION REQUESTED. REVISED US TEXT FOR PARAS 8, 9, 18 AND 19 BY APRIL 2. DEPARTMENT'S COMMENTS ON TEXT BELOW, TOGETHER WITH SUGGESTION FOR ADDITIONAL FINAL PARAGRAPH IN CONCLUSIONS, IN TIME FOR ECONOMIC COMMITTEE MEETING APRIL 7. US AND OTHER ALLIES WILL, OF COURSE, HAVE OPPORTUNITY FOR FURTHER REVISIONS DURING DISCUSSION OF SPC.

4. NEW TEXT FOR FIRST 12 PARAGRAPHS:

QUOTE:

SECURITY AND POLITICAL IMPLICATIONS OF THE ECONOMIC SITUATION

1. THE TRAUMATIC ECONOMIC EVENTS OF THE PAST YEAR-INFLATION, RECESSION, THE MASSIVE INCREASE IN OIL PRICES, GROWING DEPENDENCE ON CERTAIN RAW MATERIALS AND UNCERTAINTIES AS REGARDS
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THEIR SUPPLY, TOGETHER WITH THE PERSISTENCE OF THE INTERNATIONAL MONETARY PROBLEMS HAVE ALTERED SEVERAL ASPECTS OF THE EAST-WEST BALANCE.

2. THE ALLIANCE IS UNDER STRAIN AND STANDS IN SOME DANGER THAT IS COHESION MAY BE WEAKENED. THE DIRECT IMPACT OF THE ECONOMIC SITUATION THUS FAR UPON THE WESTERN SECURITY STRUCTURE IS DIFFICULT TO ASSESS, BUT FOR THE MOST PART APPEARS MANAGEABLE AS LONG AS THE POLITICAL SOLIDARITY OF THE ALLIANCE IS MAINTAINED. THE PRINCIPAL RISK LIES IN THE POSSIBILITY THAT SECURE ECONOMIC PRESSURES IN THE WEST MAY LEAD TO NATIONAL MEASURES INCOMPATIBLE WITH THE FUNDAMENTAL INTERESTS OF THE ALLIANCE.

THE ECONOMIC FACTORS

E. IN 1975, THE NATO COUNTRIES FACE, INTER ALIA:

-ECONOMIC STAGNATION AND THE ATTENDANT HIGH LEVEL OF UNEMPLOYMENT, WITH LITTLE OR NO GNP GROWTH UNTIL LATE 1975 AT THE EARLIEST;

-CONTINUED INFLATION AT A HIGH RATE, ALTHOUGH HOPEFULLY FOR A NUMBER OF COUNTRIES LOWER THAN IN 1974;

-BALANCE OF PAYMENTS PROBLEMS, IN SOME CASES QUITE CRITICAL;

-DEPENDENCE UPON OUTSIDE SUPPLIERS FOR VARYING PROPORTION (IN SOME CASES VITALLY ALL) OF THEIR OIL REQUIREMENTS; IN THIS REGARD THE POSITION OF NORTH AMERICA IS HOWEVER MORE COMFORTABLE THAN THAT OF EUROPE WHICH, IN ADDITION TO OIL, IS ALSO A LARGE IMPORTER OF OTHER STRATEGIC RAW MATERIALS.

4. MEANWHILE IN THE EAST:

-THE ECONOMY IS RUN IN A WAY WHICH SHIELDS IT TO A CONSIDERABLE DEGREE FROM THE IMPACT OF OUTSIDE EVENTS; THIS IS NOT SO IN THE WEST WHERE THE ECONOMIC OPERATE ON AN OPEN SYSTEM WHICH IS RECEPTIVE TO WORLD EVENTS.

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-ECONOMIC GROWTH, ALTHOUGH THE 1975 OBJECTIVES HAVE BEEN SCALED DOWN, WILL CONTINUE IN WARSAW PACT COUNTRIES AND WILL EXCEED THE NATO COUNTRIES PERFORMANCE. HOWEVER, SOME SHOWDOWN OF THE INCREASE IN CONSUMER BENEFITS MAY OCCUR. IN GENERAL, THE USSR-BECAUSE OF ITS WEALTH OF RESOURCES-IS MUCH BETTER OFF THAN ITS ALLIES DEPENDENT UPON LARGE IMPORTS OF ENERGY AND RAW MATERIALS.

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C O N F I D E N T I A L SECTION 2 OF 3 USNATO 1699

-WESTERN INFLATION HAS NO SERIOUS IMPACT ON THE USSR,
EAST EUROPEANS BEING MORE DEPENDENT BECAUSE OF THE IMPORTANCE OF
THEIR EXTERNAL TRADE,

- THE USSR BENEFITS FROM A SURPLUS IN ITS CONVERTIBLE
CURRENCY EARNINGS. SHIFTING TERMS OF TRADE AND BALANCE
OF PAYMENTS STRAINS IN OTHER PACT COUNTRIES WILL IN-
CREASE THEIR DEPENDENCE UPON THE SOVIET UNION.

-THERE IS VIRTUAL SELF-SUFFICIENCY FOR THE WARSAW PACT
COUNTRIES IN MOST CRITICAL COMMODITIES, NOTABLY OIL.
WHILE AGRICULTURE IS UNPREDICTABLE, AND POTENTIALLY
A WEAK SPOT, FOOD WOULD NOT SHAPE UP AS A MAJOR FACTOR
IN THE EAST-WEST BALANCE, UNLESS THERE WERE A SERIOUS
FAILURE IN THE SOVIET HARVEST.

THE EFFECT ON SECURITY

5. IN THE SHORT TERM, ONE OF THE MOST CRITICAL PROBLEMS
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FACING NATO IS THE DANGER THAT CENTRIFUGAL FORCES GENERATED BY
ECONOMIC EVENTS MAY WEAKEN THE COHESION OF THE ALLIANCE. THERE
MIGHT BE A DANGER THAT THE PURSUIT OF NATIONAL ECONOMIC INTEREST
WOULD LEAD TO BILATERAL POLITICAL CONCESSIONS TO EASTERN COUN-
TRIES, WHICH COULD JEOPARDIZE THE SOLIDARITY OF THE ALLIANCE.
ATTEMPT TO RESOLVE ECONOMIC DIFFICULTIES BY POLICIES BASED ON A
NARROW VIEW OF NATIONAL INTEREST WOULD REDUCE THE WELFARE OF ALL.
THIS WOULD MOREOVER, TEND TO CRODE THE ABILITY OF NATO TO ACT
AS A UNIFIED FORCE IN TIMES OF EMERGENCY. THERE HAVE, HOWEVER,
BEEN RECENT INDICATIONS OF THE WILINGNESS OF THE ALLIANCE TO
WORK TOGETHE TO REINFORCE THEIR POLITICES OF COOPERATION AND
CONCENTRATION.

6. IT WOULD BE MISLEADING TO INFER FROM THE WEST'S
CURRENT ECONOMIC STRAITS THAT ITS MILITARY PREPAREDNESS WILL OF
NECESSITY SUFFER IN DIRECT PROPORTION. INDEED THE DISPARITIES
BETWEEN THE WEALTH, IMPORTANCE OF POPULATION, SOCIAL AND ECO-

NOMIC BACKGROUND, AS WELL AS POLITICAL/ECONOMIC SYSTEMS OF NATO AND THE WARSAW PACT RENDER DIFFICULT ANY ADEQUATE ASSESSMENT OF THE ECONOMIC AND MILITARY BALANCE BETWEEN EAST AND WEST. (FOR EXAMPLE, ALTHOUGH THE NATO COUNTRIES ARE CONSIDERABLY RICHER AND HAVE RELATIVELY MORE MEN UNDER ARMS WORLDWIDE THAN DOES THE WARSAW PAT, THE PACT EARMARKS OVER TWICE AS GREAT A PROPORTION OF ITS GNP FOR MILITARY EXPENDITURE, AND HAS INCREASED ITS DEFENCE OUTLAYS AT A GREATER RATE THAN HAS NATO).

7. IT IS CERTAIN, HOWEVER, THAT IF ECONOMIC PROBLEMS WERE TO GROW FURTHER, THERE WOULD BE DOMESTIC PRESSURES, TO REDUCE MILITARY EXPENDITURES IN MANY NATO COUNTRIES. INDEED, IN A DETERIORATING ECONOMIC CLIMATE THERE COULD BE A WEAKENING OF THE WILINGNESS OF THE POPULATION TO ASSERT ITSELF AGAINST POSSIBLE THREATS FROM OUTSIDE, GROWING RELUCTANCE TO ACCEPT THE NECESSARY DEFENCE BURDENS AND THE FOREGOING COULD INCREASE IN SOME COUNTRIES THE RISK OF POLITICAL RADICALIZATION. ANOTHER FACTOR WORKING TOWARDS A CONTRACTION OF MILITARY EXPENDITURES COULD WELL BE THE NEED TO FIND ADDITIONAL FINANCE FOR CONSERVATION AND DEVELOPMENT OF ENERGY AND BASIC PRODUCTS. WHILE SUCH REDUCTIONS MIGHT BEMANAGED SO AS TO MINIMIZE THEIR IMPACT ON THE WEST'S ABILITY TO DETER OVERT MILITARY AGRESSION, THEY COULD GENERATE NEW STRAINS WITHIN THE ALLIANCE ON ONE HAND AND MISLEADING POLITICAL SECURITY COMMITMENTS ON THE OTHER. SUCH REDUCTIONS
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COULD HAVE AN ADVERSE EFFECT ON THE COMMON DEFENSE TO THE EXTENT THAT THEY:

-IMPLY A LACK OF POLITICAL WILL ON THE PART OF THE NATO MEMBERS TO KEEP PACE WITH THE WARSAW PACT IN THE AREA OF DEFENSE COMMITMENTS;

-HAMPER NATO FORCE IMPROVEMENT PROGRAMS; AND

-STRAIN WESTERN ABILITIES TO MAINTAIN UNIFIED POSITIONS ON EAST/WEST POLITICAL AND MILITARY NEGOTIATIONS.

8 AND 9 TO BE SUPPLIED US.

10. IT IS EXPECTED THAT THE USSR WILL CONTNUE TO INCREASE ITS IMPORTS-MAINLY OF EQUIPMENT AND MACHINERY-FROM THE CONVERTIBLE CURRENCY AREA OVER THE NEXT SEVERAL YEARS. THESE IMPORTS-ESTIMATED AT SOME \$7.5 - 8.5 BILLION THIS YEAR, AND GROWING SOMEWHAT OVER THE NEXT SEVERAL YEARS-ARE OF IMPORTANCE TO INDIVIDUAL WESTERN INDUSTRIES. THEY ALSO CONSTITUTE AN INCREASE ALBEIT NOT A MOJOR ONE. IN SOVIET/WEST INTERDEPENDENCE. ON THE OTHERHAND, THERE IS A GREATER DEGREE OF INTERDEPENDENCE BETWEEN SEVERAL OTHER COMECON COUNTRIES AND THE WEST DERIVED FROM GROWING TRADE RELATIONS. IT SHOULD, NEVERTHELESS, BE REALIZED THAT EVEN IF IN THE CASE OF GROWING MUTUAL TRADE RELATIONS THE RESULTING DEPENDENCE OF THE EAST MAY NOT BE INDIGNIFICANT WITH RESPECT

TO INDIVIDUAL PROJECTS, IT IS LIKELY TO BE INFERIOR TO THAT OF THE WEST WHEN SEEN IN OVERALL ECONOMIC TERMS. MOREOVER, A PERSISTENCE OR WORSENING OF ECONOMIC TROUBLES IN THE WEST COULD INCREASE THE IMPORTANCE OF COMMUNIST MARKETS FOR NATO COUNTRIES. ON THE OTHER HAND, CURRENT EFFORTS AIMING AT INCREASED ECONOMIC INTEGRATION IN CONECON ARE LIKELY TO LIMIT SOMEHOW THE DEGREE OF DEPENDENCE OF WARSAW PACT COUNTRIES ON TRADE WITH THE NON-COMMUNIST WORLD.

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11. MOST EAST EUROPEAN COUNTRIES WILL HAVE TO BOOST EXPORTS TO THE USSR, AS FROM THIS OR NEXT YEAR, TO PAY THE INCREASED BILL FOR SOVIET OIL. TO SOME EXTENT, OF COURSE, THE RISE IN SOVIET PRICES WILL BE OFFSET BY THE HIGHER PRICES QUOTED BY THE EAST EUROPEANS FOR THEIR OWN PRODUCTS. NEVERTHELESS, SUCH A DEVELOPMENT MAY NECESSITATE A SLOWDOWN IN THE RATE OF GROWTH OF THEIR EXPORTS TO THE WEST (BUT NOT NECESSARILY A REDUCTION IN ABSOLUTE TERMS) AND OR A SLOWER RATE OF GROWTH IN THE AMOUNT OF MANUFACTURED GOODS DESTINED FOR THEIR DOMESTIC MARKETS. IN ANY CASE, IT IS QUITE LIKELY THAT THEIR DEPENDENCE UPON THE SOVIET UNION WILL BE INCREASED; THIS COULD TO SOME EXTENT BE ALLEVIATED IF MEDIUM AND LONG TERM CREDITS WERE AVAILABLE FROM THE WEST. HOWEVER THIS MAY BECOME LESS EASY FOR TWO REASONS:

1) WESTERN COUNTRIES ARE CURRENTLY CONSIDERING A TIGHTENING OF THE TERMS UNDER WHICH EXPORT CREDITS ARE GRANTED.

2) AS SOME COMECON COUNTRIES INDEBTEDNESS GROWS, NATO
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COUNTRIES MAY HESITATE BETWEEN THE POLITICAL INTEREST OF HELPING CERTAIN EAST EUROPEAN COUNTRIES WITH EXPORT CREDITS AND THE RISK OF DECELING WITH UNSOLVENT DEBTORS. THERE IS NO DOUBT THAT THE EXISTING DEBT BURDEN OF SEVERAL EASTERN COUNTRIES WILL CONSTRAIN THEIR ABILITY TO FINANCE FURTHER IMPORTS FROM CONVERTIBLE CURRENCYAREAS.

12. ALTHOUGH THE SHORT TERM PROSPECTS OF ECONOMIC GROWTH OF THE SOVIET ECONOMY SEEM BETTER THAT THOSE OF NATO COUNTRIES, THE COMPARISSON SHOULD NOT BE OVERPLAYED. WHILE COMMUNIST COUNTRIES DO NOT SUFFER FROM RECESSION, AS THIS TERM IS UNDERSTOOD IN THE WEST, THERE ECONOMICS HAVE EXPERIENCED ANDMAY STILL EXPERIENCE SOME FLUCTUATIONS AND SETBACKS, AND ARE BESET WITH MAJOR STRUCTURAL WEAKENESSES, LARGELY AS A RESULT OF THEIR SYSTEM OF CENTRALISED PLANNING. IN ADDITION, THEIR ECONOMIC GROWTH STARTS FROM A MUCH LOWER BASE. USSR PER CAPITA GNP, FOR EXAMPLE, IS STILL WELL BELOW THAT OF MOST NATO MEMBER COUNTRIES. THE OTHER WARSAW PACT COUNTRIES HAVE AN EVEN LOWER PER CAPITA PRODUCT, APART FROM CXECHOSLOVAKIA AND THE GDR.

IT APPEARS THAT THE BALANCE OF THE RESOURCES WHICH NATO AND THE WARSAW PACT HAVE AVAILABLE FOR BOTH ECONOMY AND DEFENCE HAS, TO A DEGREE DIFFICULT TO ESTIMATE, BEEN TILTED FOR THE TIME BEING IN FAVOUR FOF THE EAST. NEVERTHELESS, IT IS RECOGNIZED THAT THE INDUSTRIAL CAPACITYOF THE WEST REMAINS SUPERIOR TO THAT OF THE SOVIET UNION AND ITS ALLIES. IN THE EVENTUALITY OF A PROTRACTED CONFRONTATION, HOWEVER, WHEREAS THE WARSAW PACT WOULD BE PRACTICALLY SELF SUFFICIENT IN ENERGY AND STRATEGIC RAW MATERIALS, THE NATO ALLIES WOULD BE DEPENDENT-THE EUROPEEANS TO A VERY LARGE EXTENT, AND THE NORTH AMERICANS MUCH LOSS SOON RAW MATERIALS AND ENERGY IMPORTED FROM AREAS WHICH ARE NOT UNDER THEIR CONTROL OF EVEN NECESSARILY FRIENDLY.

THERE IS MOREOVER SOME QUESTION AS TO THE ABILITY OF NATO COUNTRIES TO COPE SIMULTANEOUSLY WITH PERMANENT INFLATION AND A STATE OF RECESSION PARTLY DUE TO EXTERNAL FACTORS, SUCH AS THE DRAMATICALLY CHANGE CONDITIONS ON THE WORLD MARKETS FOR ENERGY AND BASIC PRODUCTS.

THIS NEW SITUATION IN THE WEST WHICH INVOLVES A DECLINING REAL DOMESTIC PRODUCT, UNEMPLOYMENT AND MORE PRESSING SOCIAL
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CLAIMS CONSTITUTES AN ADDTIONAL STRAIN ON PUBLIC RESOURCES AND ACTS AS A BRAKE ON THE POLITICAL WILL TO MAINTAIN DEFENCE PROGRAMMES.

NONE OF THESE CONSTRAINTS AFFECT TO THE SAME EXTENT THE ECONOMICS OR THE DEFENCE CAPACITY OF THE WARSAW PACT COUNTRIES. NEVERTHELESS THEY SEEM TO REMAIN HANDICAPPED, IN THE CONOMIC FIELD, BY BACKWARD TECHNOLOGY AND A LACK OF ATTRACTIVE EXPORT RESOURCES, WHICH PREVENTS THEM FROM TAKING FULL ADVANTAGE OF THE VARIOUS OPPORTUNITIES OF COMPETING WITH THE WEST IN DIFFERENT FIELDS.

CURRENT DEVELOPMENTS WITHIN THE ALLIANCE CLEARLY DEMONSTRATE THE INTERDEPENDENCE OF MILITARY, POLITICAL AND ECONOMIC FACTORS, ALL OF WHICH COULD AFFECT ITS SECURITY IN A SITUATION OF EMERGENCY.

THE PRESENT SITUATION WOULD SEEM TO CALL FOR MEMBER COUNTRIES TO GIVE GREATER CONSIDERATION TO THE POLITICAL AND SECURITY INTERESTS OF THE ALLIANCE IN ADOPTING COMMON POSITIONS IN INTERNATIONAL FORA SPECIALIZED IN ECONOMIC MATTERS. THIS WOULD HELP AVOID POSSIBLE CONFLICTS BETWEEN PROPOSED ECONOMIC MEASURES AND DEFENCE REQUIREMENTS.

THE PRESENT ECONOMIC DIFFICULTIES AND THE NEED TO MAKE THE BEST USE OF PUBLIC RESOURCES TO OVERCOME RECESSION WITHOUT FEEDING INFLATION LEND A NEW URGENCY TO PLANS FOR HARMONISATION AND STANDARDIZATION WITHIN NATO OF ARMAMENTS AND EQUIPMENT. IN THIS CONNECTION, JOINT PRODUCTION PROGRAMMES UTILIZING THE CAPACITY OF SEVERAL COUNTRIES WHICH MIGHT LEAD TO THE CREATION OF A NATO ARMAMENTS POOL COULD BE A MEANS OF IMPROVING COST EFFICIENCY IN THE FIELD OF DEFENCE

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